



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Larry D. Lisenbee

**SUBJECT: MONTHLY FINANCIAL REPORT
FOR FEBRUARY 2004**

DATE: April 2, 2004

Approved /s/

Date 4/6/04

INFORMATION ONLY

The Monthly Financial Report (MFR) for February was jointly prepared by the City Manager's Budget Office and the Finance Department and is presented here for the City Council's review.

OVERVIEW

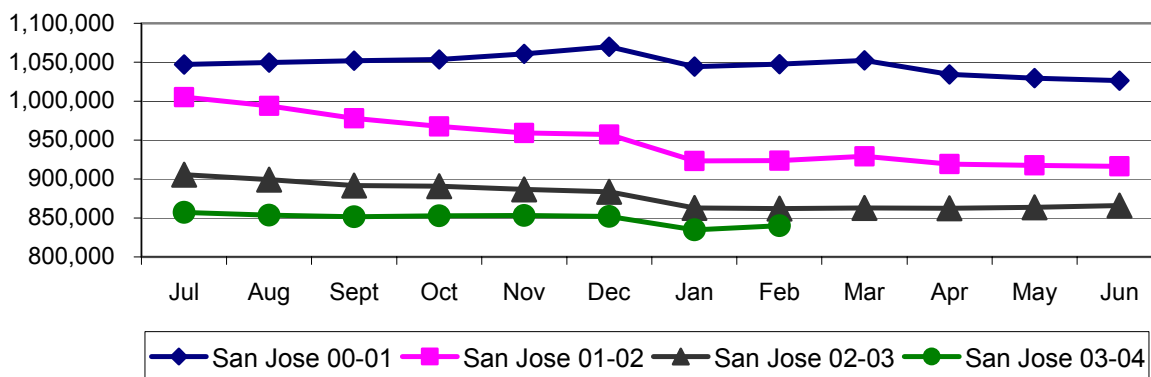
On an overall basis, our review of the financial activity for the City through February confirms that the City remains mired in a stagnant local economy where a severe slowdown is now in its third straight year. This situation continues to negatively impact collections of most of the City's major revenue sources. Although the regions's economic situation appears to have stabilized somewhat, the signs of emerging economic growth being seen both nationally and elsewhere in the State are not yet being evidenced locally.

Since our last report, we have received, however, some mildly encouraging news concerning our largest economically sensitive revenue category – General Sales Tax. Although not reflected in the February numbers contained in this report, the City received second quarter (October through December sales activity) General Sales Tax receipt information last week. For the first time in the last eleven quarters, receipts were actually up slightly, rising 2.7% from the prior year level. A significant portion of that increase, however, actually represented a delayed payment from one source that was more appropriately attributed to last fiscal year. With this taken into account, this most recent quarter grew by just under 1%, and brought year-to-date Sales Tax collections this fiscal year to approximately flat when compared with last year. Although hardly evidence of a strong economic rebound, these results may at least indicate that we have finally hit bottom of what had been a long and steady drop in the City's largest revenue source. Nothing we have seen, however, indicates that we should expect to see any significant rebound in Sales Tax receipts in the immediate future, and in fact, our estimates for the next fiscal year for this source continue to call for growth of less than 2%.

It is been our belief for some time that the most crucial indicator of economic health continues to be the employment situation in the County, and regrettably, a very sluggish employment situation and continued job losses still characterize our economy (see below).

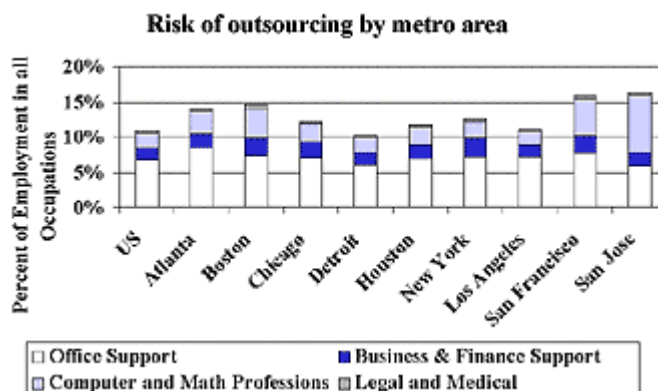
OVERVIEW (CONT'D.)

San José Metropolitan Statistical Area
 (Santa Clara County)
Employment: Total Jobs Comparison



February employment numbers indicate that while the rate of the drop-off in the number of jobs may have lessened, and the unemployment rate leveled off, job losses continue to plague the Valley, particularly in the key technical and manufacturing job categories. In fact, the job situation continues to be of significant concern across the country. Despite indications of economic growth, improvement in the employment situation continues to be stubbornly elusive. In the most recent example of this situation, the latest jobs report released by the U.S. Labor Department, for the month of February, reported the U.S. economy as a whole created only 21,000 new jobs – significantly below the 125,000 jobs that had been forecasted and far below the 200,000 or more jobs that are usually created by this point in an economic recovery. The trend of offshore migration of many of the types of jobs previously prevalent in the area continues, and seems to be accelerating. There are still absolutely no signs of the type of increases in employment that we believe will be needed to pull us out of the current economic situation.

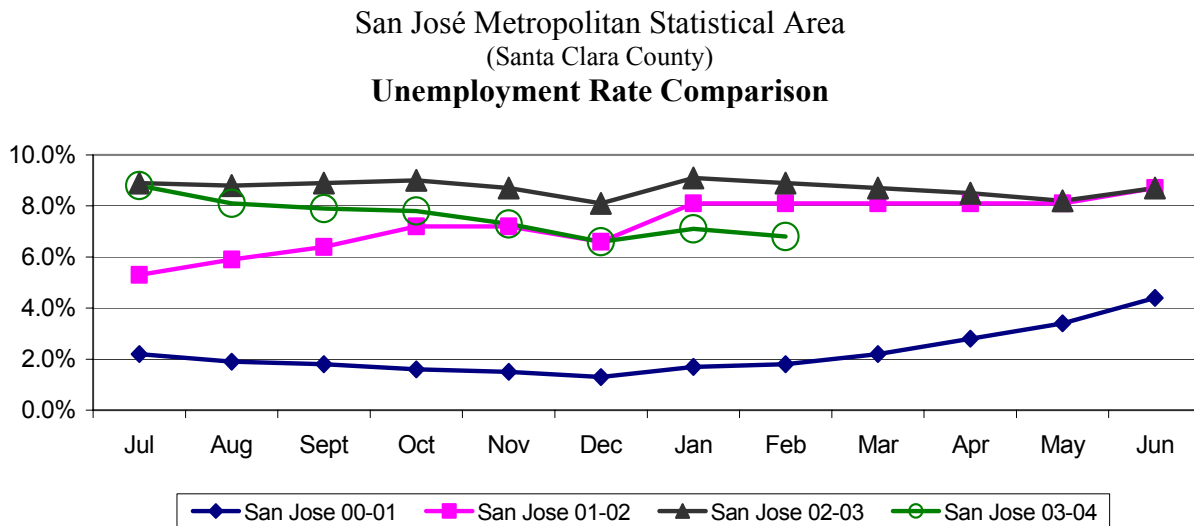
Many economists, in fact, believe that the Bay Area is particularly susceptible to outsourcing of jobs, which is often cited as one of the major reasons that job growth remains low nationwide. As noted below, a recent research report published by University of California, Berkeley researchers indicated that San Jose is at a particularly high risk for outsourcing compared with other large metropolitan areas in the United States.



OVERVIEW (CONT'D.)

The graph above, based on Bureau of Labor Statistics data, projects how outsourcing of jobs is likely to vary by geographic area, and by job classification within those areas. (*Source: Research Report-Bardhan and Kroll, Fisher Center for Real Estate and Urban Economics-UC Berkeley*) The graph indicates a belief that San Jose has the most risk of outsourcing followed closely by San Francisco.

February's unemployment rate of 6.8% was down slightly from January's adjusted rate of 7.1% (see below). However, the one seemingly bright sign in the report (the number of jobs in the County ticked up slightly, increasing by 5,100, from 835,000 to 840,100) appears to be a result of normal seasonal hiring patterns rather than any indication of true growth. The overall job situation continues to be bleak. San José experienced an overall 2.5% decrease in jobs for the year, and the County unemployment rate through February remained well above both the State and national rates, which were 6.5% and 6.0%, respectively. Significantly, even though the durable goods manufacturing sector gained 600 jobs, the highest one month gain since 2000, this key manufacturing sector is still down 6.6% for the year. The biggest contributor of this decline is again in our most important economic sectors: electronics equipment, industrial machinery, and instruments and related products industries. The MBIA MuniServices October economic report summarized our situation quite well by pointing out that "the Bay Area in the past year has actually lost more jobs than the entire state, meaning that the rest of the state has added jobs even as this region continues to lose them."



In summary, the first eight months of the year were characterized, as have the last two years, by continuing weakness in all of our key economically sensitive revenues. Fortunately, however, the 2003-2004 General Fund Adopted Budget revenue estimates were based on an assumption of continued economic problems. As a result, even taking into account the specific one-time unanticipated problems in two key revenue sources, Motor Vehicle License Fees and Electricity Utility Taxes, which will result in collections falling short of budgeted expectations in those two categories by approximately \$2.4 million, overall collections in the General Fund are performing just slightly below (between \$3.0-\$5.0 million) budgeted levels.

OVERVIEW (CONT'D.)

We have taken this status into account in our most recent projections for year-end fund balance included in the 2004-2005 General Fund Forecast. We believe that savings in expenditures and liquidation of encumbrances will offset the underage in revenue collections, leaving us with a slight positive balance (\$11.0 million, excluding rebudgets and reserves) in the General Fund at the end of the year.

Our final year-end revenue collection status will, however, depend heavily on the final outcome for two key revenues. The first will obviously be Sales Tax collections for the remainder of the year. Two full quarters of collections remain to be received, and as noted above, although the March quarterly receipts are a positive sign, it is still too early to know whether we have hit a temporary plateau or are really seeing signs of the bottom of the Sales Tax slide. The other major unresolved issue is, of course, the potential loss of State Vehicle License Fees (VLF) resulting from the actions of the new Governor repealing the increase in those fees. Even though the Governor took executive action to continue the flow of these funds and payment has been received for amounts owed through February, there is still no amount appropriated for that purpose, and challenges to the Governor's authority remain. We continue to have a significant exposure should the backfill not be provided (approximately \$3 million per month).

It should be noted that in response to the continued weak economic performance, and in compliance with recommendations included in the Mayor's 2003-2004 Mid-Year Budget Actions Memorandum approved by the City Council on February 17, 2004, the City has continued, and in fact strengthened, the aggressive strategies that have been in place for well over two years. The hiring freeze which has been in place for two and one-half years continues, and stringent controls remain in place for discretionary expenditures in every category in the City. Most recently, at mid-year, the savings from the 2003-2004 General Fund Departmental Cost/Position Management Plans for the 2003-2004 fiscal year, which cumulatively totaled approximately \$8.6 million, were transferred to the 2004-2005 Future Deficit Reserve which now totals over \$16 million, and on March 23, the City Council approved the deletion of 100 General Fund positions.

GENERAL FUND

Revenue Collections

General Fund revenues through February 2003 totaled \$399.2 million. This was an increase of \$0.3 million (0.1%) from the February 2002 level of \$398.9 million. This comparatively flat performance was primarily driven by one-time transfers in the Transfers and Reimbursements category in the current year along with increases in the following revenue categories: Property Tax, Utility Tax, Licenses and Permits, Fines, Forfeits, and Penalties, Revenue from Local Agencies, Departmental Charges, and Other Revenue. Growth in those categories was partially offset by decreases in the following revenue categories: Sales Tax, Transient Occupancy Tax, Franchise Fees, Use of Money and Property, Revenue from the State of California, and Revenue from the Federal Government.

GENERAL FUND (CONT'D.)

The following discussion highlights General Fund revenue activities through February:

KEY GENERAL FUND REVENUES
((\$000's))

| <u>Revenue</u> | <u>2003-2004</u> <u>Estimate</u> | <u>YTD</u> <u>Actual</u> |
|---------------------|-------------------------------------|-----------------------------|
| Property Tax | \$ 96,444 | \$ 55,193 |

Year-to-date Property Tax revenues reflect collections in Secured Property Tax, Unsecured Property Tax and the smallest property tax category, SB 813 Property Taxes (supplemental taxes).

Secured Property Tax revenues through February of \$42.6 million are 7.3% higher than the prior year. Information from the County indicates that the City should expect to meet the current budget estimate (\$79.3 million). It should be noted, however, that tax roll adjustments are still occurring and will continue to take place until the end of May. As a result, final conclusions concerning the status of Secured Property Taxes cannot be made until total receipts are received in June.

Current and Prior Unsecured Property Taxes are driven by the value of personal property, typically equipment and machinery used by business and industry for manufacturing and production. Through February, Unsecured Property Tax receipts of \$10.6 million are 11.4% below last year's level of \$11.9 million. A falloff had been anticipated, and this performance is within budgeted levels. Performance in this category over the past decade has been extremely volatile and subject to sharp changes as the economy shifts. Staff will continue to monitor this revenue source closely and work with the County to obtain additional information to determine whether adjustments might be needed before year-end.

With the adjustments for accrual reversals and timing differences, SB 813 payments through February of \$1.4 million are down 32.8% from last year's comparable collections of \$2.2 million. Reduced collections in this category, representing payments for taxes owed on recent housing resales, usually indicate a reduction in the resale of older homes or a slowdown in the turnover of recently resold homes. The Adopted Budget anticipated a significant decline in this category, presuming a drop of 10.0% from the prior year level. We will need to watch closely to ascertain whether an additional adjustment may be necessary later in the year.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
((\$000's) (Cont'd.))

| <u>Revenue</u> | <u>2003-2004</u> <u>Estimate</u> | <u>YTD</u> <u>Actual</u> |
|------------------|-------------------------------------|-----------------------------|
| Sales Tax | \$ 128,818 | \$ 67,168 |

General Sales Tax receipts for February represent only State formula advance payments. Collections of \$67.2 million tracked 3.6% lower than the \$69.7 million collection in the prior year. Because these are advance payments, however, the decline through February is not necessarily indicative of an actual drop in receipts.

As discussed in the overview, in the last two weeks, the City received the most recent quarterly Sales Tax report from the State representing sales activity for October through December. Although the City's collections levels continue to be weak, for the first time in more than two and a half years, Sales tax collections were actually up, increasing 2.7% from the prior quarter. Although this is good news in that the long string of quarter-to-quarter declines has been broken, this should be tempered with the knowledge that included in this quarterly increase were one-time dollars more appropriately attributed to last fiscal year. With this fact taken into account, it can be seen that collections are actually approximately flat from last year through the first two quarters of this year.

San Jose's increase was slightly less than that experienced by the San Francisco Bay Area (up 2.9%) while the State as a whole had significantly greater growth (4.3%). The South Bay regional economy clearly continues to be the hardest hit area in the State, if not the nation.

Preliminary information from MBIA MuniServices, the City's Sales Tax consultants, indicates that the performance in the City's Sales Tax receipts for the most recent quarter, although up just slightly from last year, actually represents a relatively mixed performance in most economic sectors. Although the Business-to-Business category increased slightly (up 1.7%), the activity within the sector was mixed. Increases in electronic equipment (up 32.4%) and energy and chemical sales (up 21.3%) were offset by decreases in leasing (down 28.1%) and office equipment (down 13.8%). The increase in General Retail (up 4.4%) was mainly the result of an increase in apparel stores (up 24.8%), offset by decreases in florist/nursery (down 11.3%) and recreation products (down 5.7%). After accounting for timing issues, the Transportation sector declined (down 8.2%) led mainly by decreases in used car sales (down 24.5%) and auto parts/repairs (down 13.7%). One bright spot was the solid increase in construction (up 11.9%), led by increases in wholesale building materials (up 15.8%) and retail building materials (up 8.5%). The following lists the largest General Sales Tax economic sectors and their percentage of the total for the 2003-2004 second quarter: Business-to-Business at 27.1%; General Retail at 25.9%; Transportation at 22.4%; Food Products at 13.5%; and Construction at 10.4%.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
 (\$000's) (Cont'd.)

| <u>Revenue</u> | 2003-2004 <u>Estimate</u> | YTD <u>Actual</u> |
|--------------------------------|------------------------------|----------------------|
| Transient Occupancy Tax | \$ 6,118 | \$ 2,934 |

Transient Occupancy Tax collections through February of \$2.9 million continue to be very disappointing, and are below last year's level of \$3.2 million for the same period and 15.5% lower than the year-to-date estimate of \$3.4 million. This decrease indicates continued softness in this area with minimal growth expected for the rest of the fiscal year. This is in contrast to our budgeted expectation for some improvement in this sector beginning this fiscal year. As a result, a \$600,500 downward adjustment in this revenue category was approved as part of the Mid-Year Budget Review.

The hotel occupancy rate for January had offered some hope when reports indicated that activity in that month had returned to nearly the same level as the prior year. However, the February 2004 occupancy rate in the largest hotels was very disappointing, as occupancy has dropped back to a dismal 51.8%, significantly down from both the February 2002 rate of 66.4%, and the January 2004 rate of 54.3%. An additional sign of continued weakness in the local hospitality market is the fact that while the number of rentable rooms remains relatively stable, the average room rate continues to drop, from \$116.72 in February 2003 to \$115.65 in February 2004. We will continue to monitor this situation, but believe that yet another downward adjustment to the estimate for this revenue source will almost certainly be required by the end of the year.

| <u>Revenue</u> | 2003-2004 <u>Estimate</u> | YTD <u>Actual</u> |
|-----------------------|------------------------------|----------------------|
| Franchise Fees | \$ 32,406 | \$ 16,027 |

Collections of \$16.0 million from Franchise Fees were below the February 2002 collection level of \$16.4 million. This negative variance reflects net lower collections in Electricity and Gas Franchise Fees. The receipts related to Electricity and Gas Franchises Fees are the result of formula-driven estimated payments from Pacific Gas & Electric (PG&E), based on actual collections in calendar year 2002, and are not necessarily indicative of actual expected receipts. In addition, as reported to the City Council in June 2003, net receipts also reflect the repayment of \$183,236 to PG&E for overpayments made to the City in 2002-2003. In April 2004, PG&E will calculate the actual Franchise Fees due in 2003-2004 based on calendar year 2003 activity.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
 (\$000's) (Cont'd.)

| <u>Revenue</u> | 2003-2004 <u>Estimate</u> | YTD <u>Actual</u> |
|---------------------------------|------------------------------|----------------------|
| Franchise Fees (Cont'd.) | \$ 32,406 | \$ 16,027 |

It should be noted that the California Public Utilities Commission (CPUC) recently approved a settlement agreement between Pacific Gas & Electric Company, its parent PG&E Corporation, and the CPUC, which paves the way for the utility to emerge from bankruptcy. A federal bankruptcy judge later confirmed the agreement. This settlement agreement provides for significant rate reductions to the utility's customers. Although there are not enough details currently available for an exact analysis of the impact of the rate reductions, an initial review indicates the possibility of significant ongoing reductions of both Electricity Franchise Fees and Utility Taxes in the combined range of \$3.0 million to \$3.5 million. In addition, we have received slightly lower than anticipated collections from City Generated Tow Franchise Fees, however, it is still anticipated that City Generated Tow Franchise Fees will meet budgeted expectations.

Commercial Solid Waste Franchise Fees of \$5.0 million are approximately 11.0% above the prior year level of \$4.5 million. Preliminary discussions indicate, however, that this performance is actually due to timing differences in receipts and variances in accruals compared to the previous year. In fact, preliminary estimates indicate that this revenue category may actually fall below budgeted expectations due to the continued weak economic climate as well as to commercial waste diversion programs. The Budget Office will continue to work with the Environmental Services Department to analyze current year performance and assess whether a downward revenue adjustment should be recommended.

| <u>Revenue</u> | 2003-2004 <u>Estimate</u> | YTD <u>Actual</u> |
|--------------------|------------------------------|----------------------|
| Utility Tax | \$ 64,979 | \$ 42,360 |

Utility Tax collections of \$42.4 million are 5.5% above last year's level of \$40.1 million. This performance reflects slightly higher collections in Gas, Water, and Telephone Utility Taxes, offset by lower collections in the Electricity Utility Tax. As discussed in prior MFRs, the projection for a shortfall in the Electricity Utility Tax is the result of a September announcement by the California Public Utilities Commission that it has ordered an unanticipated one-time rebate to PG&E customers. The negative impact of that rebate on the City is projected at approximately \$1.1 million.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
 (\$000's) (Cont'd.)

| <u>Revenue</u> | 2003-2004 <u>Estimate</u> | YTD <u>Actual</u> |
|------------------------------|------------------------------|----------------------|
| Utility Tax (Cont'd.) | \$ 64,979 | \$ 42,360 |

In addition, as noted above, the CPUC recently approved a settlement agreement between Pacific Gas & Electric Company, its parent PG&E Corporation, and the CPUC that provides for significant rate reductions to the utility's customers. Although there are not enough details currently available for an exact analysis of the impact of the rate reductions, an initial review indicates the possibility of significant ongoing reductions of both Electricity Franchise Fees and Utility Taxes in the combined range of \$3.0 million to \$3.5 million.

However, in light of the \$2.0 million downward adjustment approved in the Mid-Year Budget Review, combined with the increases in natural gas prices and slight increases in overall usage for Gas, Water, and Telephone, it is anticipated that this revenue category will meet modified budget expectations.

| <u>Revenue</u> | 2003-2004 <u>Estimate</u> | YTD <u>Actual</u> |
|-----------------------------|------------------------------|----------------------|
| Licenses and Permits | \$ 66,157 | \$ 47,635 |

On an overall basis Licenses and Permits revenue of \$47.6 million through February was 12.1% above the prior year level of \$42.5 million.

Cardroom Business Tax collections of \$4.9 million are well above the prior year level of \$4.2 million. This performance actually reflects comparison with the period of last year affected by the Bay 101 bankruptcy filed in July 2002 where revenue was not received during that period. This revenue category is expected to meet budgeted expectations of \$7.5 million.

Disposal Facility Tax revenue of \$7.7 million was 20.5% lower than the prior year level of \$9.7 million. This reflects the fact that BFI and Waste Management have taken issue with the removal of the Alternate Daily Cover exemption approved by the City Council last year. Pending a resolution of this \$1.8 million dispute, by agreement with the City Attorney's Office, BFI and Waste Management are paying amounts related to alternative daily cover into an escrow account, rather than the General Fund. The Attorney's Office is attempting to negotiate an outcome that will hold the General Fund harmless for any loss of revenue, but we will need to work with the Environmental Services Department and the City Attorney's Office to monitor the status of this issue and its impact on City revenue collections.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
 (\$000's) (Cont'd.)

| <u>Revenue</u> | 2003-2004 <u>Estimate</u> | YTD <u>Actual</u> |
|---------------------------------------|------------------------------|----------------------|
| Licenses and Permits (Cont'd.) | \$ 66,157 | \$ 47,635 |

Fire Permit revenues of \$3.9 million are flat when compared to the prior year's revenues. This performance is below the amount anticipated in the budget, and as a result a \$0.4 million downward adjustment was approved as part of the Mid-Year Budget Review. Even with the revised revenue estimate and expectations of higher activity levels before year-end, current projections indicate that these revenues may still end the year below the revised budgeted amount. At the present time, this reduction in revenues can be only partially offset by salary savings in fee program costs. The status of the Fire Fee Program will continue to be closely monitored, however, a further downward adjustment to the estimate for this revenue source may well be required by the end of the year.

Building Permit revenues of \$14.2 million, in contrast, are tracking well above both the budgeted level (13.5%) and last year's collection level (43.3%). Revenues through February collected in all categories performed at or above anticipated levels. A change in the building code that was to be effective on November 1 apparently resulted in a significant increase in October activity. Although revenue collections have smoothed out during the year, it is currently anticipated that Building Permits could end the year above estimates by as much as \$1.3 million. It should be noted that new commercial activity fell to its lowest level in seven years and that no new industrial construction permits were issued for the second consecutive month.

| <u>Revenue</u> | 2003-2004 <u>Estimate</u> | YTD <u>Actual</u> |
|----------------------------------|------------------------------|----------------------|
| Use of Money and Property | \$ 8,492 | \$ 5,015 |

The Use of Money and Property revenue of \$5.0 million in February was significantly below the prior year level of \$7.4 million, reflecting lower cash balances and interest earnings. The General Fund cash balance for February was down to \$159.6 million, as compared to the prior year's balance of \$177.2 million, a decline of 9.9% or \$17.6 million. Although a significant decline in cash balances had been anticipated, this level was below that assumed in the Adopted Budget, and a downward adjustment of \$1.0 million was approved through the Mid-Year Budget Review. As a result, this revenue category is now expected to meet budgeted expectations.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
(\$000's) (Cont'd.)

| <u>Revenue</u> | <u>2003-2004</u> <u>Estimate</u> | <u>YTD</u> <u>Actual</u> |
|---|-------------------------------------|-----------------------------|
| Revenue from the State of California | \$ 48,535 | \$ 21,448 |

Revenue from the State of California through February totaled only \$21.4 million, which represented a significant decline from the prior year collection level of \$32.4 million. The drop, of course, reflects the impact of the reduction in Motor Vehicle In-Lieu Fee (VLF) payments included as part of the State budget balancing actions. (As a reminder, what was represented as a "one-time" impact from the ramp-up time necessary to fully implement the increase in the VLF fees resulted in the postponement of the July through September VLF offset until 2005-2006. Therefore, a subsequent reduction in VLF was approved by Council as part of the State budget balancing package approved in August).

Actions that were approved by the City Council revised the budget estimate accordingly, resulting in a \$10.5 million decrease to the VLF category. As discussed in prior MFRs, subsequent to the September rebalancing actions, it was determined that a key assumption, based on State assurances, used to estimate prior year revenues in this category has proven to be incorrect. Based on statements from the State Controller, the Finance Department presumed that a VLF payment in the amount of \$1.3 million due to the City in June, which was delayed, would eventually be paid. An accrual in that amount was, as a result, included in the final 2002-2003 closing statements. We since learned that, those assurances notwithstanding, this payment will not be forthcoming. The result is an additional shortfall of \$1.3 million in current year collection totals over and above any shortfalls resulting from the actions that raised and then lowered VLF fees.

Of intense interest to the City, of course, are the implications of the action of the new Governor rescinding the increase in VLF (retroactive to when it was raised) and the potential loss of all VLF backfill to the City should the VLF backfill not be restored. It is still unclear what the final outcome of this issue will be as the Governor and the Legislature work to balance the State deficits in the current and next year. The special session of the Legislature called by the Governor to address this and other issues ended with no action to backfill VLF revenue loss. Shortly thereafter the Governor announced, with the support of the State Controller, that he would declare a State emergency and unilaterally restore the VLF backfill, at least for the remainder of the year. The legality of this action has been challenged by several legislators and the Legislative Analyst. At the time of this writing, the outcome of this dispute is still unknown. Should the final outcome prove to be the loss of backfill for the remainder of the year, the City would be forced to very quickly implement significant actions to bring the General Fund budget back into balance. Options for such actions would be presented to the Council quickly, should this prove necessary.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
 (\$000's) (Cont'd.)

| <u>Revenue</u> | <u>2003-2004</u> <u>Estimate</u> | <u>YTD</u> <u>Actual</u> |
|-----------------------------|-------------------------------------|-----------------------------|
| Departmental Charges | | |
| - Public Works | \$ 6,405 | \$ 4,817 |

Public Works revenues through February of \$4.8 million were 32.6% above the prior year level of \$3.6 million. While the best performing categories are residential engineering and non-residential engineering, nearly every category is performing better than it was through the same period last year. Current information indicates that this revenue source could exceed budgeted levels by as much as \$700,000. This increased revenue is partially offset by lower than anticipated collections in the floodplain management and water quality runoff categories. The related expenditures in this fee program have also exceeded anticipated levels as a result of increased activities. In order to maintain the fee program's cost recovery status, upward adjustments to revenues and expenditures may be necessary by year-end.

| <u>Revenue</u> | <u>2003-2004</u> <u>Estimate</u> | <u>YTD</u> <u>Actual</u> |
|-------------------------|-------------------------------------|-----------------------------|
| - Transportation | \$ 792 | \$ 893 |

Transportation Revenues of \$0.9 million tracked 128.8% above the prior year level of \$0.4 million. The strong performance has been driven by unanticipated one-time receipts for Signal Review in the North Coyote Valley, higher than anticipated collections in the Miscellaneous Traffic Charges and Street Tree Planting categories, and Residential Permit Parking collections which have tracked strongly at the beginning of this year due to permit renewals in the summer. As a result, current year-to-date collections have already exceeded the budgeted estimate. The Budget Office will continue to work with the Department to project the year-end collection level, bringing forward appropriate adjustments, if necessary, as more information becomes available.

| <u>Revenue</u> | <u>2003-2004</u> <u>Estimate</u> | <u>YTD</u> <u>Actual</u> |
|---|-------------------------------------|-----------------------------|
| - Planning, Building, & Code Enforcement | \$ 5,257 | \$ 3,275 |

Planning Permit revenues of \$3.3 million is well above last year's collection level at this point in time, and tracking at anticipated levels. Revenue levels for 2003-2004 assumed the same level of activity as 2002-2003, with fee increases of 15.0% as approved by the Council.

GENERAL FUND (CONT'D.)

REVENUES (CONT'D.)

KEY GENERAL FUND REVENUES
 (\$000's) (Cont'd.)

| <u>Revenue</u> | <u>2003-2004</u> <u>Estimate</u> | <u>YTD</u> <u>Actual</u> |
|----------------------|-------------------------------------|-----------------------------|
| Other Revenue | \$ 16,190 | \$ 11,208 |

Other Revenue collections of \$11.2 million are \$2.2 million above the prior year level of \$8.9 million. This increase from the prior year primarily reflects a planned increase in reimbursement from the Arena Authority. Overall collections appear to be within budgeted expectations.

| <u>Revenue</u> | <u>2003-2004</u> <u>Estimate</u> | <u>YTD</u> <u>Actual</u> |
|-------------------------------------|-------------------------------------|-----------------------------|
| Transfers and Reimbursements | \$ 86,381 | \$ 71,687 |

Transfers and Reimbursement collections of \$71.7 million were significantly above the prior year level of \$68.7 million. This performance through February, however, was primarily driven by various budgeted transfers to the General Fund, including transfers from the Healthy Neighborhood Venture Fund (\$10.0 million) and the Vehicle Maintenance and Operations Fund (\$2.9 million). Overall collections appear to be within budgeted expectations.

EXPENDITURES

Through February, General Fund expenditures of \$420.5 million were 7.3% below (down \$33.3 million) the prior year level of \$453.8 million. Encumbrances of \$37.5 million were 24.9% below (down \$12.4 million) the prior year level of \$49.9 million. Expenditures and encumbrances (\$458.0 million) through February constitute 63.0% of the total 2003-2004 revised budgeted uses of funds (\$727.6 million, excluding reserves).

After incorporating the adjustments approved as part of the Mid-Year Budget Review, cumulative departmental and non-departmental expenditures appear to be within or below approved budgeted levels through February. At this time, only one department, the Fire Department, is spending at a level that would lead to exceeding its appropriation by year-end.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

The following discussion highlights significant General Fund expenditure activities through February:

KEY GENERAL FUND EXPENDITURES
 (\$000's)

| <u>Department</u> | <u>2003-2004 Budget</u> | <u>YTD Actual</u> |
|-------------------|-----------------------------|-----------------------|
| Police | \$ 224,680 | \$ 138,862 |

Overall, Police Department expenditures are tracking at slightly lower than estimated levels through February. Overtime expenditures through February were below expected levels at \$6.0 million or 48.2% of the budgeted level (compared to the estimated level of 62.8%). In February 2003, the Department implemented guidelines on overtime usage and the Department continues to be proactive in managing overtime. In the Sworn Recruitment and Training Program, 33 Officers that were part of the January 2003 Academy were street-ready in October 2003.

The compensatory time balance at the end of February is 197,555 hours for sworn personnel. This level represents a drop of 21,840 hours (down 9.9%) from the June 2003 balance of 219,395 hours, and a slight increase from the February 2003 balance of 196,233 hours.

| <u>Department</u> | <u>2003-2004 Budget</u> | <u>YTD Actual</u> |
|-------------------|-----------------------------|-----------------------|
| Fire | \$ 111,884 | \$ 72,030 |

As discussed in previous MFRs, expenditures for the Fire Department continue to track above budgeted levels. This is entirely the result of higher than anticipated Personal Services expenditures, primarily overtime overages.

Present projections indicate that at current continued expenditure levels, year-end costs would exceed budgeted levels by as much as \$2.2 million. A portion of that overage, however, is expected to be reimbursed. In support of efforts to fight Southern California wildfires, the Fire Department dispatched four companies and support staff. The Department is currently obtaining further information on the total amount and timing for the reimbursement of these costs. At current spending levels, therefore, assuming full reimbursement for the Mutual Aid efforts, the department's unreimbursed year-end costs would be over the budget amount by approximately \$1.6 million.

GENERAL FUND (CONT'D.)

EXPENDITURES (CONT'D.)

KEY GENERAL FUND EXPENDITURES

(\$000's) (Cont'd.)

| <u>Department</u> | <u>2003-2004 Budget</u> | <u>YTD Actual</u> |
|-----------------------|-----------------------------|-----------------------|
| Fire (Cont'd.) | \$ 111,884 | \$ 72,030 |

Efforts do continue to address the inadequate paramedic staffing levels in the department. As of the end of February, the Department has a total of 207 filled front-line (122) and support (85) paramedics. As discussed during last year's budget process, the front-line total of 122 is short of the 147 that are necessary to fully staff all apparatus. During last fiscal year, the Department implemented several strategies to attempt to close the gap in front-line paramedics. In March 2003, the accelerated accreditation program for 13 Firefighter Paramedics resulted in an increase in the number of front-line Paramedics. In addition, 16 individuals have completed a Paramedic Academy and are in the internship phase of their training. A significant portion of the projected overexpenditure will, however, result from an unanticipated delay in the length of time necessary for these medics to complete the certification process. For reasons that are still unclear, the training program is now approximately four months behind the original schedule.

This delay alone will result in unbudgeted overtime costs of just under \$400,000, nearly a quarter of the projected overexpenditure. When the front-line Paramedics are accredited, the number of front-line Paramedics is anticipated to increase to a projected level of 135, still slightly short of the full need. The Budget Office is continuing to work with the Department to develop mitigation strategies to bring expenditures within budgeted levels by year-end.

CONTINGENCY RESERVE

Through February, the General Fund Contingency Reserve was \$22,566,675, down by \$2.5 million from the 2003-2004 Adopted Budget level of \$25,086,675. The following revisions to the Contingency Reserve were approved through February:

- A decrease of \$600,000 to provide an increase to the Hayes Mansion Conference Center Line of Credit in order to allow the Conference Center to remain open and operational while the City selects and completes negotiations with a new property manager.
- A decrease of \$1.5 million to provide or guarantee a letter of credit on behalf of the Silicon Valley Football Classic. At this point, it is anticipated that none of this funding will actually be required to be expended.
- A decrease of \$100,000 to provide funding for an environmental impact report for the Almaden Youth Sports Complex.

GENERAL FUND (CONT'D.)

CONTINGENCY RESERVE (CONT'D.)

- A decrease of \$300,000 to provide funding for consultant services related to the cable television franchise renewal project.
- A decrease of \$20,000 to provide additional funding for an evaluator that reviews and investigates complaints that are filed with the San José Elections Commission.

OTHER FUNDS

Construction and Conveyance Tax Funds

Continuing the positive trend experienced at the end of last fiscal year, Construction and Conveyance Tax collections through the first eight months of the year have significantly exceeded both prior year actuals and budgeted estimates. This represents stronger than anticipated durability of the local real estate market, which to our surprise continues to remain virtually unfazed by the local economic slowdown. The number of property transfers for all types of residences in February increased over 26% from February 2003, and these homes also took less time to sell with the average days-on-market decreasing from 77 days in February 2003 to 44 days in February 2004. Year-to-date property transfers have also increased by approximately 35% when compared to prior year activity.

Through February, \$20.0 million in actual tax revenues has been received (83.5% of the 2003-2004 revised estimate of \$24 million). This collection level was 30.7% higher than revenues received through February 2003. In addition to these revenues, the City has since received March Conveyance Tax receipts which totaled \$2.1 million. This result was 31.2% higher than the March 2003 amount of \$1.6 million. Due to the stronger than anticipated performance of this revenue, a \$4.0 million upward adjustment was approved as part of the Mid-Year Budget Review. While the news remains positive and we will likely still end the year above budgeted levels, we should continue to exercise caution when projecting year-end receipts. The prolonged economic downturn, and the end of the recent decline in mortgage rates could still begin to negatively impact housing sales, which are the primary drivers of this revenue.

Other Construction-Related Revenues

After a strong January, February's construction-related revenues dropped significantly, making February the second weakest month of the year. In February, new commercial construction activity fell to its lowest level in seven years, and for the second consecutive month, no new industrial construction permits were issued. Even in light of February's lackluster performance, revenues are tracking above year-to-date estimates. The year-to-date total of the seven revenue sources monitored for this report is \$17.0 million, a decrease of 1.3% from the \$17.2 million collected through the same period last year. Despite the stronger than anticipated showing to date, we continue to believe that this does not indicate any significant revival of industrial construction activity. A recovery in that sector would appear to still be some time away.

OTHER FUNDS (CONT'D.)

Other Construction-Related Revenues (Cont'd.)

Nevertheless, on an overall basis activity in the other sectors, primarily residential, has boosted revenues slightly above year-to-date estimates for 2003-2004, which was built allowing for a 33.6% drop from the prior year's actual collections of \$30.0 million.

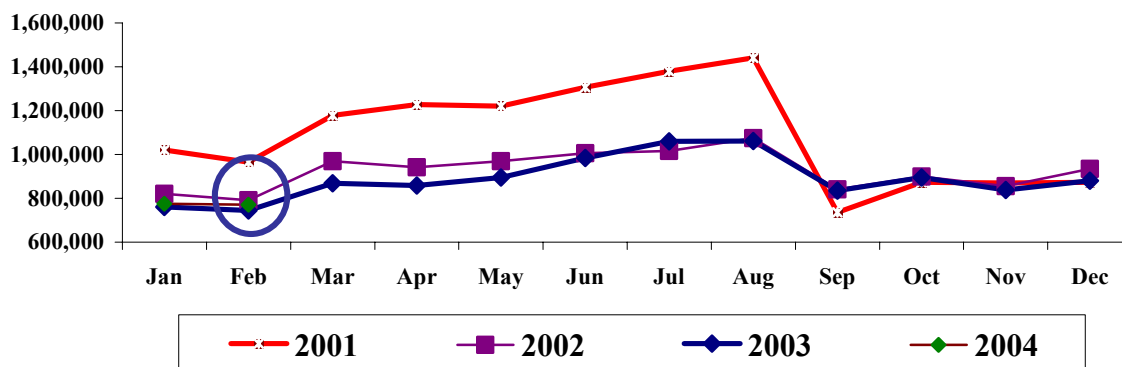
Consistent with the overall pattern, the major revenue sources – Building and Structure Construction Taxes and Construction Excise Taxes – are outperforming year-to-date estimates but tracking slightly below prior year actuals. Building and Structure Tax receipts through February totaled \$5.9 million (81.3% of the current 2003-2004 estimate of \$7.3 million), which represents a decrease of 4.0% from the revenues collected through the same period last year (\$6.2 million). The budgeted estimate for this category allows for a 32.4% drop. Construction Excise Tax revenues through February totaled \$8.9 million (80.7% of the current 2003-2004 estimate of \$11.0 million), which represents an 7.3% decrease from last year's \$9.6 million received over the same period. The budgeted estimate for this category allows for a 35.1% drop in 2003-2004.

Other construction related revenues are generated by Municipal Water Service Connection Fees, Sanitary Sewer Fees, Storm Drain Fees, Residential Construction Taxes, and Municipal Water Major Facilities Fees. All of these categories are tracking above prior year levels and are expected to end the year at or above estimates.

Airport Funds

On a year-to-date basis, the Norman Y. Mineta San José International Airport (SJC) has enplaned and deplaned 7.1 million passengers, a decrease of 0.4% from the figures reported through February 2003. Monthly passenger activity for February increased by 3.5% from 2003 levels, in part due to the extra day added by the leap year. In February 2004, the Airport served 770,783 passengers.

**Norman Y. Mineta San José International Airport
Monthly Passengers**



OTHER FUNDS (CONT'D.)

Airport Funds (Cont'd.)

Terminal C passenger activity for February 2004 increased 2.7%, and year-to-date activity is 3.7% greater than that recorded through February 2003. Terminal A activity increased 4.0% in February to February comparisons, but is 2.6% lower than 2002-2003. Annual mail, freight and cargo totaled just over 155.9 million pounds, a 19.5% decrease from 2002-2003. This decrease is largely attributable to the termination of operations of Emery Worldwide Airlines and Kitty Hawk Air Cargo in San José. February 2004 taxicab operations increased by 2.2% from those in February 2003, but are 1.5% lower than those recorded year-to-date. Short-term parking exits are down by 3.5% for the year and daily exits are down by 11.6%.

Through February 2004, year-to-date operating revenues of \$56.07 million were 1% higher than the estimated budget. Performance of various revenue categories showed mixed results. Revenues posting higher results than the estimated budget were terminal rentals, airfield, and general and non-aviation revenues. Terminal rentals were 4.0% higher than the estimated budget due to additional space occupied by Southwest Airlines. Airfield revenues continued to outpace the estimated budget mainly because of the rise in the activities of the commuter airlines. Prior year adjustments of in-flight kitchen revenues that were reflected during the current fiscal year also contributed to the increase in airfield revenues. Higher interest income and transfers from the Fiscal Agent, as well as increases in land and building rentals, contributed to a 16.0% increase in general and non-aviation revenues.

Revenues falling behind estimated levels were landing fees, terminal concessions and miscellaneous rents, parking and roadway, and petroleum programs. Airlines decreased their operations to cope with lingering weak travel demand and the shift of passenger traffic from larger to regional aircraft that correlated to lower landing fees. Terminal concessions and miscellaneous rents were 2.0% lower than the estimated budget due to "true-up" refunds of concession fees (pertaining to prior year) paid to the rental companies (approximately \$822,000). Parking and roadway revenues fell 1.0% behind the estimated budget, dragged down by lower long-term parking and taxi revenues. Petroleum program revenues were only 87.0% of the estimates because of the termination of operations by Kitty Hawk and Charter America, which accounted for 14.0% of the prior year's petroleum revenues.

Expenditures in the Airport Maintenance and Operations Fund through February were tracking below budgeted levels in both personal services and non-personal/equipment categories. Savings realized thus far are the result of internal savings targets established by the Airport to bring costs into balance with anticipated revenues and prepare for conservative activity projections in 2004-2005. In Airport personal services, expenditures totaled 58.8% of the modified budget compared to a benchmark level of 62.8%. Savings are attributed to departmental vacancies and reduced overtime expenses. Through the end of February, the department carried 66 vacancies, of which 38 were funded. Overtime use through February totaled \$154,000 (or just 37.9% of budget), as compared to \$196,751 year-to-date in 2002-2003.

OTHER FUNDS (CONT'D.)

Transient Occupancy Tax Fund

As described above, Transient Occupancy Tax (TOT) collections of \$4.3 million through February remain disappointing, and were down 9.4% from the same period last year. The February 2004 occupancy rate in the largest hotels of 51.8% was significantly down from the February 2003 rate of 66.4% and below the January 2004 rate of 54.3%. In addition, reflecting the soft market, while the number of rentable rooms remained stable over the prior year, the average room rate continued to slip, dropping to \$115.65 in February 2004 from \$116.72 in February 2003.

Based on trends as they appeared in January, a downward adjustment of \$900,000 was approved as part of the Mid-Year Budget Review. However, even with this reduction, the fund would have still required a modest recovery in occupancy rates and room rates for the rest of the year to achieve the revised level of projected revenue. There are significant risks that this improvement will not occur. Staff will continue to monitor this fund closely, but if the recovery fails to materialize, additional reductions will be required later in the year.

Integrated Waste Management Fund

Integrated Waste Management Fund revenues are tracking to end the year below the original estimate, primarily due to customers downsizing their carts in both Single-Family and Multi-Family Dwelling sectors further than anticipated. As a result, an \$860,015 downward adjustment to revenues and expenditures was recommended and approved as part of the Mid-Year Budget Review. It is now expected that this fund will end the year within the revised budgeted estimates.

CONCLUSION

Although we may be seeing the beginnings of a flattening out of the downward momentum in City revenues, we do not see any rebound in revenues in the near term. Economic indicators and City revenue collections confirm the fact that the City and the South Bay region continue to be plagued by a lingering economic slowdown, and appear likely to remain so for the immediate future. Since the revenue estimates in the Adopted Budget assumed this approximate situation, however, we believe that performance to date is still generally consistent with budgeted estimates. As discussed above, the outcome of the State battle over VLF backfill revenues for local governments, and our own Sales Tax performance for the remainder of the year will be the critical determinants of our final status.

Although the breadth and depth of the weak local economy has clearly been greater and longer than any of us anticipated, to date we have been able to weather the situation without dire consequences, largely due to the aggressive management measures implemented as soon as it became apparent that the economy had peaked. We remain committed to the strict implementation of these measures, and the development of additional options for further cost cutting for Council consideration should the situation deteriorate further.

April 2, 2004

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CONCLUSION (CONT'D.)

We must also remain cognizant of the fact that a significant portion of the danger facing the City is external -- the loss of VLF revenue and the ongoing debate at the State level involve efforts to prevent the drastic impact on local government services statewide if the backfill is not restored.

Regardless of the outcome of the current State process, tough decisions lie ahead. Our projections call for large shortfalls in our own revenues as the City faces a fourth straight year of falling revenues and raising budget deficits. Planning has been under way for some time to develop options for how to address next year's situation, no matter how dire it may be. We remain confident, however, that no matter how large the problem we face, our track record of prudent financial planning will continue, and that working together we can and will respond appropriately.

As always, staff will continue to closely monitor our current year financial status and report regularly to the City Council on any and all significant developments through this reporting process.

/s/

LARRY D. LISENBEE
Budget Director